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Intelligence Memorandum

Brazil: The Politics of Economic Priorities

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
5 June 1972

INTELLIGENCE MEMORANDUM

Brazil: The Politics of Economic Priorities

President Emilio Medici has recently indicated that he intends to take a larger personal interest in economic matters. The military-backed administrations that have governed Brazil since the 1964 "revolution" have generally left economic policy formulation and implementation in the hands of capable civilian technicians. The result has been a record of rapid economic growth. But Medici has been convinced by other advisers that too little progress has been made in reducing inflation. His intrusion into economic affairs and his decision to give inflation top billing may weaken his relationship with his chief economic architect, Finance Minister Antonio Delfim Neto. Thus far the rift is a small one, but, if it were to grow into a major dispute within the government over economic policy, it could erode the military unity upon which the regime depends and could weaken Medici's ability to select his successor.

Note: This memorandum was prepared by the Office of Current Intelligence and coordinated within CIA.

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Medici's Views

1. The President first suggested a shift in economic priorities in his nationwide speech on 31 March, the eighth anniversary of the "revolution" which overthrew leftist nationalist Joao Goulart. After reciting a litany of his administration's economic accomplishments and goals, Medici turned to emphasizing Brazil's problem of inflation, which he described as a "plague upon this century." He stressed that it is wrong to maintain that inflation must accompany development, declaring that, in fact, inflation hinders economic growth, stimulates social instability, and cuts into the family budget. While noting that annual price increases had been reduced from about 90 percent in 1964 to less than 20 percent in 1971, Medici called for a redoubling of government efforts to stabilize prices. He declared that federal and state governments were expected to balance their budgets and avoid putting pressure on the financial system. He urged private industry not to indulge in unjustified price rises.

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Reasons for Concern

3. Medici's preoccupation with inflation seems to have been lately developed. The top economic goal of the 1964 "revolution" was to control inflation, but since then economic growth has taken precedence. The government estimates that the annual growth in the gross domestic product was at least 9 percent in the 1968-70 period, and an extraordinary 11.3 percent last year. Administration spokesmen, including Delfim Neto, have maintained that, as long as rapid economic expansion continued, Brazil could live with an inflation rate of some 20 percent, the rate that has been registered in each of the past three years. These spokesmen argue that any drastic curb on inflation might in fact hamper growth. But some government officials and military officers believe that more effort should go into improving upon the hard-won financial stability thus far achieved. These men view inflation as a dark spot in the otherwise bright picture.

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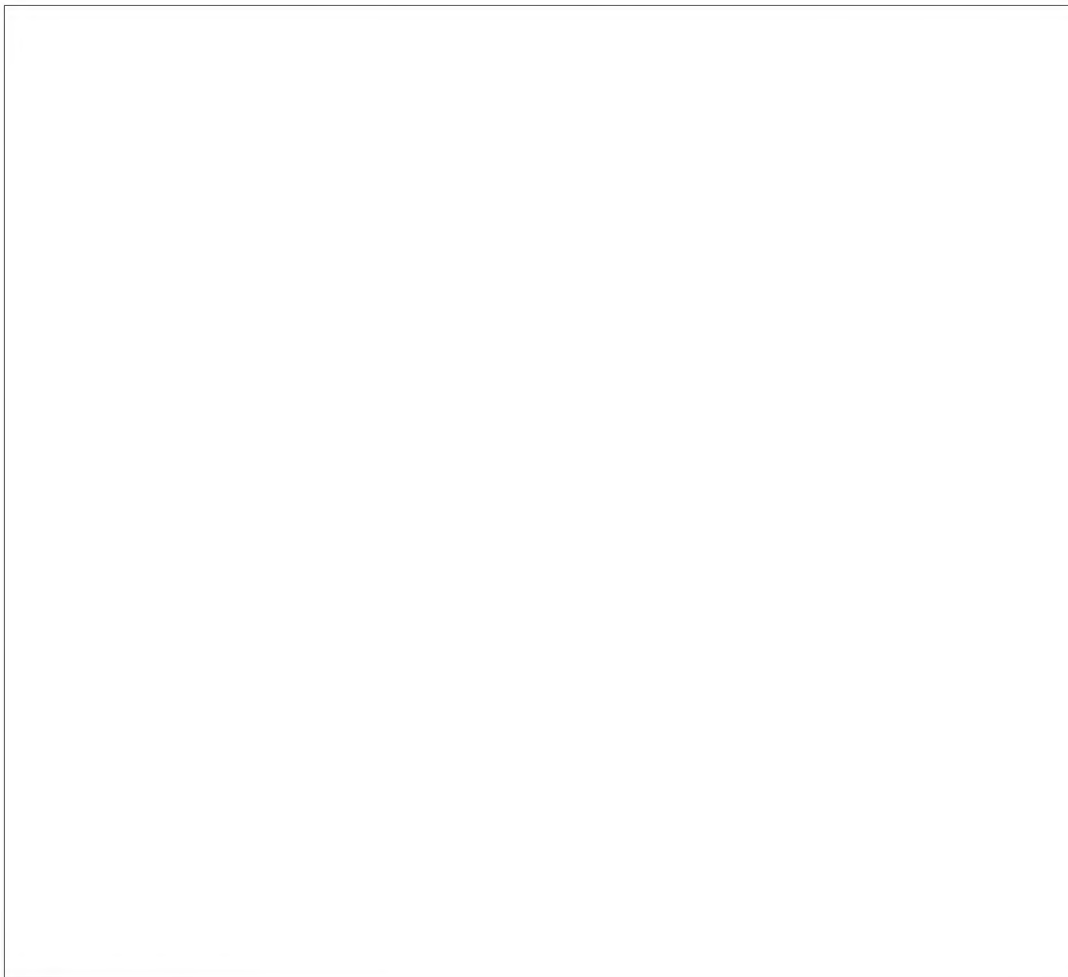
4. Medici's decision to shift economic priorities may be in part a response to military dissatisfaction. His action may have been fostered by a worsening of the inflation problem over the past few months. Preliminary evidence suggests that the rate of inflation picked up during the first quarter of this year, after declining steadily during the latter part of 1971. The inflationary rate also rose during the first quarter of last year, when drought in some parts of the country forced up prices. Production failures do not seem to explain the upsurge in prices early in 1972, however. The rise in prices this year may signal the renewal of basic inflationary pressures. Brazilian officials are acutely sensitive to signs of inflationary pressures, partly because of the country's unhappy past experience with inflation and partly because of its balance of payments situation. During the past four years, inflation has been restrained in part by a large flow of imports. Despite the rapid growth of exports, the trade balance has fallen steadily, and now runs a large deficit. Large amounts of foreign capital are coming into the country; this capital from abroad has been more than adequate to cover the trade deficit. Foreign exchange reserves are high and still growing. Foreign debt is also increasing, however, and the government's concern about this problem could be heightened by a fear that renewed inflation would weaken the country's credit standing abroad and threaten the supply of foreign capital that Brazil will continue to require for some years to come.

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Prospects



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9. Medici's action in calling for major change in the country's economic course without consulting Delfim Neto demonstrates that the minister is not indispensable. When Medici selected his cabinet in 1969, he warned that the men chosen had to work as a team and that he would not tolerate any "errant stars." The President recognizes that Delfim Neto deserves much of the success for Brazil's "economic miracle" and that he is held in particularly

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high regard in international financial circles. But the minister is fundamentally a technician with no particular base of political support. His replacement by an equally competent economist would probably cause no major adverse reaction in Brazil.

10. Medici's concern over the performance of his finance minister is based on a perception that a marked deterioration of the economy, especially a substantial rise in inflation, would pose a serious problem for his administration. The legitimacy of his regime is based on effective performance in the economic area as well as on political tranquility. As long as senior military officers and important economic groups, such as the Sao Paulo industrialists, have confidence that the administration is fully in control of the economy and is following sound policies, support of the government will probably remain solid. A serious division of opinion in the officer corps, either over goals or personalities, could eventually erode military unity. Medici is doing everything possible to prevent issues from arising that could endanger his control over the process of selecting his successor. He will therefore be anxious to keep the rift with Delfim Neto from broadening into a major dispute that could strain military unity and bring Medici's capacities to control the succession into question.

11. If the President believes that Delfim Neto has come wholeheartedly to support the goal of cutting inflation, the minister will probably be kept in the government. Because of Delfim Neto's strong commitment to economic growth, it may be difficult for him to accept an anti-inflationary policy that could sacrifice some growth. If Delfim Neto does not go along with the new line, he seems destined to be replaced. In any case, he now must face competition for influence in domestic economic policy-making, and he will be forced to be even more responsive to the priorities set by Medici and the military.

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